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VIA E-MAIL AND OVERNIGHT MAIL
Chief Justice John D. Minton, Jr.
Supreme Court of Kentucky
305 Warren County Justice Center
1001 Center Street
Bowling Green, KY 42101

Re: Kentucky Court of Justice Court Facilities Construction Program

Dear Chief Justice Minton:

For the first phase of our comprehensive review of the Kentucky Court of Justice Court Facilities Construction Program ("Courthouse Construction Program"), you have requested that we provide you with a legal opinion whether Kentucky statutes, Kentucky Administrative Regulations, Kentucky case law, the Kentucky Court of Justice Rules of Administrative Procedures relating to the Courthouse Construction Program and the Contract Documents relating to the Courthouse Construction Program ("Kentucky Law and the Contract Documents") require the Construction Manager-At Risk ("CM-At Risk") or the General Contractor ("GC") on a Courthouse Construction Program project to post a Performance and Payment Bond equivalent to 100% of the Contract Price or Contract Sum on such a project. We have concluded that Kentucky Law and the Contract Documents do require that each CM-At Risk and each GC furnish a Performance and Payment Bond, either as a single bond or as separate bonds, equivalent to 100% of the Contract Price or Contract Sum ("100% Performance and Payment Bond"). The GC or CM-At Risk must furnish such 100% Performance and Payment Bond, with the Owner as the obligee, upon execution of its contract with the Owner.

The balance of this opinion letter will provide you with a synopsis of our opinion, outline the process which we undertook to form our opinion, and delineate the bases for our opinion. As to all factual matters material to the opinion, we have relied upon and assumed the truth and accuracy of the factual representations made in the interviews we conducted and the facts otherwise provided by the individuals referenced herein.

SYNOPSIS OF OPINION

In our opinion, Kentucky Law and the Contract Documents require that the CM-At Risk or GC post a 100% Performance and Payment Bond, with the Owner as obligee, upon its execution of its contract with the Owner. There are multiple independently sufficient reasons supporting this conclusion. First, the Rules of Administrative Procedures of the Court of Justice, Part X, Real Property Management ("APs") require that a CM-At Risk or GC furnish a 100%

Performance and Payment Bond on a Courthouse Construction Program project. Second, the Kentucky Model Procurement Code ("KMPC") also mandates that a CM-At Risk or GC post a 100% Performance and Payment Bond. Third, the Contract Documents relating to a Courthouse Construction Program project also set forth requirements for the CM-At Risk or GC to furnish a 100% Performance and Payment Bond. In our opinion, the APs take precedence over the contract provisions requiring that the CM-At Risk or GC post a 100% Performance and Payment Bond; but they all point to the same conclusion. When we read the APs, in conjunction with the KMPC and the Contract Documents, we can reach only one conclusion, namely, that the CM-At Risk or the GC on a Courthouse Construction Program project must, in fact, furnish a 100% Performance and Payment Bond, with the Owner as obligee.

Through our review of this issue, we have learned that the Construction Managers-At Risk, which might be impacted by this opinion, will contend that the Kentucky Administrative Office of the Courts ("AOC") has somehow relaxed the requirements for a CM-At Risk to furnish a 100% Performance and Payment Bond. From a legal perspective, these CMs-At Risk might argue that the AOC has waived the requirement for the furnishing of a 100% Performance or Payment Bond, that the AOC is estopped from now requiring that a CM-At Risk post a 100% Performance and Payment Bond, that the Construction Managers-At Risk have detrimentally relied on the AOC's conduct in not previously enforcing the requirement that a CM-At Risk furnish a 100% Performance and Payment Bond or that the AOC has changed the conditions of the contract. We have concluded that these CM-At Risk's arguments do not have merit. Through the APs, the Chief Justice of the Kentucky Supreme Court ("Chief Justice") retains complete authority over the procedures relating to the Courthouse Construction Program, and only the Chief Justice can make permanent changes to the APs. The Chief Justice has not made any permanent changes to the APs since June 1, 2007. In addition, specific language contained within the Contract Documents is inconsistent with any such CM-At Risk arguments regarding waiver, estoppel, detrimental reliance, changed conditions or similar theory.

For these reasons, which will be discussed in greater detail below, we conclude that a CM-At Risk or GC must furnish a 100% Performance and Payment Bond, with the Owner as obligee, upon execution of its contract with the Owner.

OUR PROCESS

In order to render this legal opinion to you, we have conducted a thorough process to gain background on the Courthouse Construction Program, to understand the issues associated with bonding on the Courthouse Construction Program projects and to evaluate the legal issues involved. This section of the opinion will outline the process which we have undertaken and describe the sources of the factual information about the Courthouse Construction Program that we are relying upon to render this opinion.

We have conducted a series of meetings with Jason Nemes (Director of AOC), Laurie Dudgeon (Deputy Director of AOC), Cindra Walker (General Counsel, Office of General Counsel, AOC), Katie Quitter (Chief of Staff and Counsel, Supreme Court of Kentucky), Jenny Lafferty (Legal Counsel, Office of General Counsel, AOC) and Leigh Anne Hiatt (Executive

Officer, Department of Public Information, AOC). We have also reviewed a number of newspaper articles which have been published throughout the Commonwealth of Kentucky relating to the Courthouse Construction Program.

We also conducted interviews with Jason Nemes, Garlan VanHook (former Executive Officer, Department of Facilities, AOC), Vance Mitchell (Department of Facilities, AOC), Sara Dent (former Legal Counsel, Office of General Counsel, AOC), Jim King (Department of Facilities, AOC), James Bauman (Department of Facilities, AOC) and Doug Teague (Acting Executive Officer, Department of Facilities, AOC). In addition, we reviewed a March 16, 2009 letter from Mr. VanHook, providing his perspective on the history of the Courthouse Construction Program and outlining his position on many of the bonding issues addressed in this letter.

We also reviewed a number of public record requests relating to the bonding issues, which were made in each of the counties in which a courthouse facility is at some stage of design or construction. In addition, we reviewed the responses to each of those public record requests. Additionally, we reviewed a series of letters exchanged among the General Counsel for The Surety & Fidelity Association of America, the General Counsel for The National Association of Surety Bond Producers, attorney John W. Hays of Jackson Kelly PLLC and various County Judge Executives throughout Kentucky.

We sent letters to all CMs-At Risk and GCs which are currently involved in a Courthouse Construction Program project or their attorneys (for those companies which we knew to be represented by counsel), soliciting responses to questions relating to the bonding issues set forth in this opinion. Accordingly, we sent letters to representatives of Branscum Construction, Inc., Alliance Corporation, Codell Construction Company, D.W. Wilburn, Inc., Trace Creek Construction, Inc., B.H. Green & Son, Inc. and Klenco Construction. Subsequently, we have evaluated the responses received from or on behalf of each of those construction companies.

We have also reviewed the potentially relevant portions of the 2000, 2005 and 2007 editions of the APs. We have also evaluated the evolution of the potentially relevant portions of those APs, from 2000 to 2005 to 2007. We have also reviewed available Contract Documents relating to the forty (40) Courthouse Construction Program projects, which are at various stages of design or construction or which are substantially complete. We also evaluated specific details, such as Performance and Payment Bonds in place, on each of those projects. We also researched the pertinent Kentucky statutes, Kentucky Administrative Regulations and Kentucky case law relating to the legal issues involved in this opinion.

Based upon this process, we believe that we have sufficient knowledge and information to render this legal opinion to you.

PROJECT DELIVERY METHODS

Chapter 11 of the 2007 APs requires that each County participating in the Courthouse Construction Program establish a Project Development Board ("PDB"), which acts as the

Owner's and the Court of Justice's ("COJ") agent during the development of the project. Section 17-1 of the 2007 APs provides that the PDB shall select one (1) of three (3) project delivery methods for the procurement of construction services. The three possible project delivery methods under the Courthouse Construction Program are General Contractor, Construction Manager-At Risk or Design-Build. The 2000 APs permitted the use of a Construction Manager-Advisor/Agent ("CM-Advisor/Agent"), but the option of using a CM-Advisor/Agent was eliminated within the 2005 APs. For purpose of your understanding the bonding issues associated with this opinion, we believe it is necessary for you to have basic understanding of the differences between a GC, CM-Advisor/Agent, CM-At Risk and Design-Builder. Again, please understand that the following definitions are intended to be extremely basic in nature and are not intended to detail the legal nuances, the rights and responsibilities, the pros or cons or practical implications of the use of these four different project delivery methods.

A GC is an entity which provides construction services to an Owner; and, typically, the GC subcontracts out a significant portion of the construction services to a number of subcontractors and suppliers. Under a GC project delivery method, the Owner executes a contract only with the GC, typically for a stipulated sum or fixed price.

A CM-Advisor/Agent is an entity which contracts directly with the Owner, for a negotiated fee, to manage and schedule the construction process. The Owner executes separate contracts with other providers of construction services and materials. The CM-Advisor/Agent, in turn, manages those providers.

Under the Courthouse Construction Program, a CM-At Risk enters into a single contract with the Owner for a pre-determined fee, based upon a maximum percentage of the project construction budget, and is reimbursed for specifically delineated costs set forth in the contract. The CM-At Risk assumes the risk for construction at a contractually guaranteed maximum price and provides consultation and collaboration regarding construction both during and after the design of the project. The CM-At Risk enters into separate contracts with various subcontractors. From a purely contractual standpoint, the primary difference between a CM-Advisor/Agent and a CM-At Risk is the contractual relationships. Under a CM-At Risk methodology, the Owner holds only one contract with the CM-At Risk, which, in turn executes contracts with various subcontractors; whereas under a CM-Advisor/Agent project delivery method, the Owner executes a contract with the CM-Advisor/Agent, and the Owner executes separate contracts with each of the other providers of construction services and materials. As stated above, the Courthouse Construction Program has not utilized a CM-Advisor/Agent project delivery method since the promulgation of the 2005 APs, which went into effect on August 9, 2005.

A Design-Builder is an entity which both designs and builds a project. The Owner enters into one contract with the Design-Builder to both design the project and build the project for an established fixed price. Typically, the Design-Builder enters into separate contracts with an Architect/Engineer to provide design services and with a GC to provide general contracting services. The Architect/Engineer enters into separate agreements with other consultants, as necessary, and the GC enters into separate contracts with various subcontractors and suppliers.

In accordance with Section 17-1 of the 2007 APs, the Design-Build project delivery method is reserved for special case large projects, as identified by the AOC's Executive Officer of Court Facilities. Based upon our understanding, no project within the Courthouse Construction Program has utilized a Design-Build project delivery method to date. Accordingly, we are not addressing bonding requirements for Design-Builders in this opinion letter.

Under the terms of the 2007 APs, the requirements for a GC and a CM-At Risk to post a 100% Performance and Payment Bond are substantially the same. Nevertheless, through our investigation, we have learned that officials at the AOC have differentiated between the manner in which a GC is required to furnish Performance and Payment Bonds on a project and the manner in which a CM-At Risk posts its mandated Performance and Payment Bonds on a project. Specifically, the AOC has required that a GC furnish a Performance and Payment Bond equivalent to 100% of the Contract Sum or Contract Price; whereas officials at the AOC have permitted CMs-At Risk to furnish a Performance and Payment Bond equivalent to the amount of their fee only (generally 5.75% to 6.50% of the project construction budget) with the Owner as the obligee on the bonds and for each of the CM-At Risk's subcontractors to furnish Performance and Payment Bonds equivalent to 100% of its subcontracted amount, naming the CM-At Risk and the Owner as obligees on the bonds (sometimes known as "dual obligees"). As will be discussed in more detail below, we have concluded that Kentucky Law and the Contract Documents do not permit such differentiation between the manners in which a GC and a CM-At Risk furnish Performance and Payment Bonds on a project within the Courthouse Construction Program.

LEGAL ANALYSIS

A. The APs

Former Chief Justice of the Supreme Court of Kentucky, Joseph E. Lambert, adopted the 2007 APs by Court Order, entered on May 22, 2007, which went into effect on June 1, 2007, and which states that they were promulgated pursuant to Sections 110(5)(b) and 116 of the Constitution of Kentucky.

The Preface to the 2007 APs states that the APs "have the force and effect of law in the Commonwealth of Kentucky." The APs are incorporated by reference in each and every GC and CM-At Risk contract under the Courthouse Construction Program, and the same language providing that the APs shall have "the force and effect of law in the Commonwealth of Kentucky" is incorporated into each contract. *See* Appendix E to 2007 APs, pages E-7 and E-11.

It is important to note that the Chief Justice has the ultimate approval of the Courthouse Construction Program and any and all procedures relating to it. The Preface to the 2007 APs states that any permanent changes to the APs can be made only upon the approval of the Chief Justice by Court Order. Section 1-4(D) of the 2007 APs states that all COJ facilities within the Commonwealth of Kentucky are subject to the ultimate direction and control of the Chief Justice. Additionally, Section 11-4(E) of the 2007 APs provides that the "Chief Justice retains

complete authority for approval or disapproval of Projects, Project designs, Project components and/or procedures." Therefore, the requirements of the APs cannot be modified or permanently changed unless approved in writing by the Chief Justice through a Court Order.

The key provisions within the 2007 APs relating to the bonding requirements for a GC or CM-At Risk on a Courthouse Construction Program project are contained within Section 15-4 of the 2007 APs. The pertinent provisions within Section 15-4 of the 2007 APs are as follows:

15-4 General Contractor (GC) and Construction Management Service Provider (CM) Bonds.

A. Required Bonds:

1. Over $25,000: Every contractor with a proposed contract for services exceeding $25,000 shall, prior to the award of such contract, give a bond or bonds to the Owner as obligee, in a form satisfactory to AP Part X, executed by a surety company authorized to do business in the Commonwealth of Kentucky, and in a penal sum equal to one hundred percent (100%) of the contract amount, as it may be increased, the conditions of which shall bind the contractor, as principal, and the surety, to the performance of the contract according to the terms, conditions, and specifications of the contract, and any changes or modifications thereto, and to the payment of all costs for labor, materials, equipment, supplies, taxes, and other proper charges and expenses incurred or to be incurred in the performance of the contract.

2. Under $25,000: Every contractor with a proposed contract for construction services costing $25,000 or less shall, prior to the award of the contract, give bond or bonds to the Commonwealth of Kentucky, as obligee, as provided in Paragraph A.1. of this Section, when required by the terms of an Invitation for Bids issued, or an advertisement and solicitation for proposals for competitive negotiations, pursuant to AP Part X. The AOC General Manager of Court Facilities may waive this bond requirement.

3. Additional bonding requirements are defined and described in other related Sections of AP Part X.

B. Bond Obligee: The provisions of Paragraph A of this Section notwithstanding, every contractor with a contract and/or purchase order for providing commodities, supplies, equipment, or services to a Project shall give bond to the Owner, as obligee, with surety satisfactory to the AOC, in a penal amount of one hundred percent (100%) of the contract price, or an amount to be determined by the PDB and AOC General Manager of Court Facilities as sufficient to assure faithful performance of the contract according to its terms.

> C. **Failure to Give Bond:** A contract shall not be awarded to any contractor who fails or refuses to give bond to the Owner. (Emphasis in original.)

Please note that the title to this particular section is "General Contractor (GC) and Construction Management Service Provider (CM) Bonds." The title to this section, therefore, is consistent with the conclusion that the bonding requirements contained in Section 15-4 of the 2007 APs apply to GCs and CMs-At Risk.

As a practical matter, every Owner contract with a GC or CM-At Risk within the Courthouse Construction Program exceeds $25,000; so the applicable provision is Section 15-4(A)(1) of the 2007 APs. That section provides that the GC or CM-At Risk shall give to the Owner bond or bonds guarantying the GC's or CM-At Risk's performance of the contract in accordance with the contract's terms, conditions and specifications and guarantying that the GC or CM-At Risk will, in effect, pay all of its subcontractors, materialmen, suppliers and taxes relating to the project. The GC or CM-At Risk can fulfill this requirement by furnishing one Performance and Payment Bond or by furnishing a separate Performance Bond and a separate Payment Bond. In either case, the single Performance and Payment Bond or the separate Performance Bond and Payment Bond must equate to 100% of the contract amount. In surety parlance, 100% of the contract amount is referred to as the "penal sum." On the one individual Performance and Payment Bond or on the separate Performance Bond and Payment Bond, the Owner must be designated as the "obligee" or the "beneficiary" of the penal sum (100% of the contract price) in the event of a default by the GC or CM-At Risk.

Section 15-4(B) of the 2007 APs bolsters the language of Section 15-4(A) by providing that the Owner must be the obligee on the single Performance and Payment Bond (or the separate Performance Bond and Payment Bond if that format is used) for the penal sum, namely, 100% of the contract price. Please recall that under a GC or CM-At Risk delivery project delivery method, the Owner only holds one contract with the construction service provider, namely, the GC or CM-At Risk. No reference is made in Section 15-4(A), in Section 15-4(B) or in any other provision of the 2007 APs of a dual obligee. The pertinent sections of the 2007 APs specify only one obligee, namely, the Owner. In every instance, the Owner must be the obligee of the single Performance and Payment Bond or the separate Performance Bond and Payment Bond with a penal sum equivalent to 100% of the GC's or CM-At Risk's contract price. For the GC, the "contract price" is the "Stipulated Sum" or "Contract Sum"; for the CM-At Risk, the "contract price" is its "Contract Sum," defined as its CM fee and the cost of the work.

Section 15-4(C) of the 2007 APs is also important. That section provides that an Owner shall not award a contract to a GC or to a CM-At Risk, which fails or refuses to give bond to the Owner, as required by Section 15-4(A)(1). Simply put, an Owner within the Courthouse Construction Program shall not award a contract to a GC or to a CM-At Risk unless the GC or CM-At Risk furnishes a single Performance and Payment Bond or a separate Performance Bond and Payment Bond equivalent to 100% of the contract price.

Section 16-1(A) of the 2007 APs also provides a basis for requiring a CM-At Risk to furnish a single Performance and Payment Bond or a separate Performance Bond and Payment Bond, equivalent to 100% of the contract price, naming the Owner as obligee. Section 16-1(A) of the 2007 AP provides that, for construction budgets greater than $3 million, the CM-At Risk must be "fully-bonded." Our review of the documents relating to all current CM-At Risk projects within the Courthouse Construction Program has confirmed that each and every CM-At Risk project exceeds $3 million. Therefore, in accordance with Section 16-1(A) of the 2007 APs, each CM-At Risk on those projects must be "fully-bonded." In light of the other provisions discussed above, to be "fully bonded" on such a project requires that the CM-At Risk must furnish to the Owner a single Performance and Payment Bond or a separate Performance Bond and Payment Bond, equivalent to 100% of the CM-At Risk's Contract Sum, i.e., its fee and the cost of all the work.

Through our review, we have learned that certain CMs-At Risk have furnished their (insufficient) Performance and Payment Bonds to the Owners significantly after contract execution and, on some projects, well after commencement of construction. It is our opinion that a GC or CM-At Risk must furnish a 100% Performance and Payment Bond to the Owner upon award of the contract, which, in the context of the 2007 APs and the Contract Documents, means furnishing said 100% Performance and Payment Bond at the time of the execution of the contract. See, for example, Sections 15-4(A), 15-4(C) and 17-12(A) of the 2007 APs and Section 11.5.1. of the AIA General Conditions.

In light of the specific language of the APs, it is our opinion that a GC or a CM-At Risk, on a project within the Courthouse Construction Program, must furnish to the Owner a single Performance and Payment Bond or a separate Performance Bond and Payment Bond with a penal sum equivalent to 100% of the contract price, designating the Owner as the obligee. The GC or CM-At Risk must furnish such 100% Performance and Payment Bond upon execution of its contract with the Owner. By the terms of the 2007 APs, these provisions have the force and effect of law of Kentucky. The Chief Justice has not modified these provisions since June 1, 2007; so these requirements remain in full force and effect for the Courthouse Construction Program.

B. The KMPC

As another independently sufficient basis for our opinion, the KMPC also requires that a GC or CM-At Risk furnish a 100% Performance and Payment Bond on a project within the Courthouse Construction Program. The KMPC is codified at KRS Chapter 45A. As discussed below, the KMPC is, in effect, incorporated by reference into the 2007 APs. In some circumstances, the KMPC may also apply directly.

As stated above, KRS 26A.160(1) gives the Chief Justice the authority to establish "rules of procedure or guidelines on matters relating to the design, financing, and construction of court facilities." In other words, KRS 26A.160(1) gives the Chief Justice the right to establish the APs. Section 17-1(A) of the 2007 APs provides that the process of obtaining construction services "shall be conducted in accordance with KRS Chapter 45A" and the APs. In other

words, the 2007 APs incorporate the requirements of the KMPC by reference. As stated above, the 2007 APs have the force and effect of law in Kentucky. Therefore, the KMPC is applicable to projects within the Courthouse Construction Program.

There may also be some situations in which the KMPC applies directly by its terms, and not just because the APs adopt KRS Chapter 45A by reference. For example, in accordance with KRS 45A.020(1), the KMPC applies to "every expenditure of public funds by this Commonwealth under any contract." If the financing arrangements for any particular project within the Courthouse Construction Program involve the expenditure of public funds by the Commonwealth under a contract, this provision may be implicated. If there is such an expenditure of public funds by the Commonwealth under a contract, such that the KMPC is applicable, KRS 45A.190 would apply directly.

KRS 45A.190 provides that, when a construction contract exceeds $40,000, a Performance and Payment Bond equivalent to 100% of the contract price shall be furnished. KRS 45A.030(6) defines the term "construction management-at-risk." KRS 45A.030(6), after defining the term "construction management at risk," provides that the "contract shall be subject to the bonding requirements of KRS 45A.190." KRS 45A.190(1), when applicable to any given project, requires that a GC or CM-At Risk furnish a 100% Performance and Payment Bond. Therefore, a GC or CM-At Risk under the Courthouse Construction Program is required to furnish a 100% Performance and Payment Bond in accordance with KRS 45A.190.

As a result of our review, we are aware that some of the CMs-At Risk, which have constructed courthouse facilities in Kentucky recently, disagree with our conclusion that the KMPC may apply directly to Courthouse Construction Program projects pursuant to KRS 45A.020(1). In any event, even if the KMPC is not deemed to apply to such projects by its own terms, the KMPC does apply as a result of being administratively adopted through the 2007 APs.

In addition, KRS 45A.343(1) provides that local public agencies may adopt the provisions of KRS 45A.345 to 45A.460. KRS 45A.435 requires that, when a construction contract is awarded in an amount in excess of $25,000, a Performance Bond in an amount equal to 100% of the contract price and a Payment Bond in an amount equal to 100% of the original contract price shall be provided to the local public agency. The Local Unit of Government, which enters into a contract for a Courthouse Construction Program project and which ends up as the Owner of the courthouse facility (*see* Section 1-4(D) of the 2007 APs), may constitute a "local public agency" for purposes of KRS 45A.345(11). If a Local Unit of Government that contracts for a particular Courthouse Construction Program project is in fact a local public agency, and if that local public agency has adopted KRS 45A.435, and if the amount involved exceeds $25,000, then a 100% Performance Bond and Payment Bond may also be required by direct application of KR 45A.435.

The KMPC mandates that the GC or the CM-At Risk furnish a 100% Performance and Payment Bond, and the requirements of the KMPC are effectively incorporated by reference into the 2007 APs through the application of Section 17-1(A). Even if the KMPC did not apply to all Courthouse Construction Program projects pursuant to Section 17-1(A), it could still apply to

such projects directly when they involve the expenditure of public funds of the Commonwealth or when the Local Unit of Government that owns the project has adopted KRS 45A.435. Therefore, the KMPC provides an independently sufficient basis for our opinion that a GC or CM-At Risk must furnish to the Owner a 100% Performance and Payment Bond.

C. The Contract Documents

The Contract Documents utilized on projects within the Courthouse Construction Program provide yet another independently sufficient basis for our conclusion that the GC or CM-At Risk must furnish a 100% Performance and Payment Bond. Section 14-3(G) of the 2007 APs provides that the form of agreement between an Owner and a CM-At Risk on a project within the Courthouse Construction Program shall be the AIA Document A121/CMc Standard Form of Agreement between Owner and Construction Manager ("A121/CMc"). *See also* Sections 14-7(D)(2) and (3) and Section 16-3(D) of the 2007 APs. Sections 14-7(D)(2) and (3) require that the standard form of agreement between Owner and GC on a project within the Courthouse Construction Program must be the AIA Document A101-1997, the Standard Form of Agreement between Owner and Contractor, where the basis of payment is a Stipulated Sum ("A101").

Among other things, Appendix E to the 2007 APs contains required amendments to the A101 agreement. Through these required changes to the A101, the 2007 APs are incorporated by reference. *See* pages E-6 and E-7 of Appendix E to the 2007 APs. The added language specifies that the 2007 APs have the force and effect of law in the Commonwealth of Kentucky and that the 2007 APs take precedence over any language or conditions stated within the contract form. As referenced above, the 2007 APs require that a GC furnish a 100% Performance and Payment Bond. As also mentioned above, the AOC has apparently enforced this requirement strictly in projects using the GC project delivery method, such that every GC on a project within the Courthouse Construction Program has, in fact, furnished a Performance and Payment Bond equivalent to 100% of the contract price. The Contract Documents, therefore, clearly require that a GC post a 100% Performance and Payment Bond on a Courthouse Construction Program project.

The Contract Documents relating to a CM-At Risk warrant a more detailed discussion. Section 8.3.1 of the A121/CMc, relating to Performance and Payment Bonds, provides that the CM-At Risk must furnish a Performance Bond and a Payment Bond on the project. The provision further states that the "amount of each bond shall be equal to _____ % of the Contract Sum." The Owner and the CM-At Risk are required to fill in the blank with the required percentage. On at least 24 of the 28 CM-At Risk projects within the Courthouse Construction Program, where the parties have executed a contract, the parties have filled in that blank with the words "100% of the Contract Sum" or words to the same effect. On the other 4 projects, the parties left the percentage blank; however, other provisions of the Contract Documents and the 2007 APs require the 100% Performance and Payment Bond, even in these circumstances where the blank has not been completed. The term "Contract Sum" is defined in Section 5.1.1 of the A121/CMc as the "Cost of the Work" and the "Construction Manager's Fee." In essence, the "Contract Sum" is similar to a GC's "Stipulated Sum" or "Contract Price." Therefore, under the

terms of Section 8.3.1 of the A121/CMc, the CM-At Risk is required to post a Performance and Payment Bond equivalent to 100% of the "Contract Sum."

Additionally, Section 16-3(D) of the 2007 APs provides that the A121/CMc agreement must include the amendments contained in Appendix E to the 2007 APs. One such amendment contained in Appendix E provides that the policies and provisions detailed in the 2007APs "shall take precedence over any language or conditions stated herein." *See* E-11, Article 11.1. Accordingly, even if Section 8.3.1. could be construed not to require the CM-At Risk to post a Performance and Payment Bond equivalent to 100% of the Contract Sum, the CM-At Risk would still be contractually required to post such a bond or bonds pursuant to Section 15-4 of the 2007 APs, which takes precedence over the language of Section 8.31 of the A121/CMc.

In addition, paragraph M(2) of Section II to Appendix E (page E-14 of the 2007 APs) states that "[n]othing contained in the Contract Documents shall create, nor be interpreted to create, privity or any other relationship whatsoever between the Owner and any other person except the Contractor." On a Courthouse Construction Program project utilizing a CM-At Risk project delivery method, therefore, no relationship exists, contractual or otherwise, between the Owner and any of the CM-At Risk's subcontractors or suppliers. If a CM-At Risk defaults on the basis of its own default in performance or its own failure to pay, an Owner generally cannot pursue a claim against one or more of the CM-At Risk's subcontractors or suppliers or against one or more of those subcontractor's or supplier's bonding companies (assuming that a subcontractor or supplier furnished a Performance or Payment Bond).

Both the A101 and the A121/CMc agreements incorporate the 1997 edition of the AIA Document A201, the General Conditions of the Contract for Construction ("AIA General Conditions"). The Owner and GC or CM-At Risk on a Courthouse Construction Program project (depending on the chosen project delivery method) might attempt to modify the bonding requirements for the project through Supplementary General Conditions, but the mandatory amendments for the GC contract and the CM-At Risk contract state that the 2007 APs take precedence over any other contract provision. Nevertheless, we have reviewed the Supplementary General Conditions on every Courthouse Construction Program project which has utilized them, and none of the Supplementary General Conditions have modified the requirement that a GC or CM-At Risk furnish a Performance and Payment Bond equivalent to 100% of the Contract Sum. In addition, none of the Supplementary General Conditions have mentioned the concept of dual obligees. It appears, therefore, that the Owners, GCs or CMs-At Risk have not modified the bonding requirements on any of the current Courthouse Construction Program projects through Supplementary General Conditions.

The Contract Documents on all GC and CM-At Risk projects within the Courthouse Construction Program also require that the GC or CM-At Risk furnish a 100% Performance and Payment Bond with the Owner as the obligee. The incorporation of the 2007 APs into the Contract Documents only bolsters this conclusion.

As outlined within this legal analysis, the 2007 APs, the KMPC and the Contract Documents each provide an independently sufficient basis for concluding that the GCs or CMs-At Risk are required to furnish either a single Performance and Payment Bond or a separate Performance Bond and Payment Bond, equivalent to 100% of the Contract Price or Contract Sum, with the Owner as the obligee. When the 2007 APs, the KMPC and the Contract Documents are read together, we can reach only one conclusion, namely, that the GC or CM-At Risk must furnish the 100% Performance and Payment Bond, with the Owner as the obligee, upon execution of its contract with the Owner.

AOC's PRACTICE

Through our review, we have learned that officials at the AOC have differentiated between the bonding requirements for a GC and the bonding requirements for a CM-At Risk. Since the inception of the Courthouse Construction Program, the AOC has required that a GC post a Performance and Payment Bond, as a single bond or separate bonds, equivalent to 100% of the Contract Sum. Since CM-At Risk became a permissible project delivery method in 2005, officials at the AOC have not objected when a CM-At Risk furnishes a Performance and Payment Bond for only its fee, which is generally 5.75% to 6.50% of the project construction budget. Additionally, officials at the AOC have not objected when a CM-At Risk furnishes a Performance and Payment Bond from each of its subcontractors, equivalent to that subcontractor's contract amount, naming the CM-At Risk and the Owner as dual obligees. In our opinion, the conduct of officials at the AOC in differentiating between the bonding requirements for a GC and the bonding requirements for a CM-At Risk on Courthouse Construction Program projects is inconsistent with the 2007 APs, the KMPC and the Contract Documents. As set forth within this opinion, both the GC and the CM-At Risk are required to furnish a 100% Performance and Payment Bond, with the Owner as the obligee.

If a GC defaults in either its performance or payment obligations on a Courthouse Construction Program project, the Owner can pursue the GC and, if necessary, the surety on its Performance and Payment Bond, up to 100% of the Contract Sum. In addition, any unpaid subcontractors or suppliers could possibly pursue the surety on the GC's Payment Bond, up to 100% of the Contract Sum, to secure payment. In this fashion, the Owner is fully protected as envisioned and specified in the 2007 APs, the KMPC and the Contract Documents.

When the CM-At Risk provides a bond for only the amount of its fee, if the CM-At Risk subsequently defaults in its performance or payment obligations, the Owner can certainly pursue a claim against the CM-At Risk; but the Owner can pursue a claim against the surety on the CM-At Risk's Performance and Payment Bond, if necessary, only to the extent of the CM-At Risk's fee. In that situation on a Courthouse Construction Program project, the CM-At Risk's Performance and Payment Bond is only for a very small percent of the Contract Sum (generally 5.75% to 6.50% of the total amount). Granted, in that situation, each of the CM-At Risk's subcontractors may have provided Performance and Payment Bonds equivalent to their respective subcontract amount. In the event of a CM-At Risk's default, however, the Owner generally cannot pursue a claim against an individual subcontractor because the subcontractor has not defaulted and because the Owner lacks privity with the subcontractor. Moreover, even if

the Owner is listed as a dual obligee on each of the subcontractors' Performance and Payment Bonds, the amount of each bond is far less than 100% of the Contract Sum. That situation creates several potential difficulties for the Owner that proper 100% Performance and Payment Bonds by the CM-At Risk would help to prevent.

For example, a default in performance by the CM-At Risk itself may produce adverse consequences far in excess of the amount of its fee; so a bond equivalent to only the amount of the CM-At Risk's fee could well prove insufficient. If a CM-At-Risk's default in performance is the source of the problem on a Courthouse Construction Program project, the Owner may have significant difficulty in successfully enforcing the Performance Bonds against subcontractors who may have individually or collectively performed in accordance with their respective obligations. Similarly, if the CM-At Risk itself defaults in its obligations to pay the subcontractors or materials suppliers, but its Payment Bond is limited to the amount of the CM-At Risk's fee, the Owner may be exposed to the risk of having to deal with payment claims from the unpaid subcontractors or material suppliers without the benefit of 100% payment bonding that the CM-At Risk is actually required to provide. Again, the Owner might encounter significant difficulty in enforcing the several Payment Bonds against the respective subcontractors, especially in light of the fact that the subcontractors themselves might be the ones who have not been paid by the CM-At Risk.

Even in those circumstances when the source of the problem giving rise to a bond claim might actually lie with the subcontractors, rather than with the CM-At Risk, the separate bonding supposedly totaling 100% leaves a strong potential for numerous gaps. Just as with the CM-At Risk itself, the problem caused by the default in performance of any particular subcontractor could cause adverse consequences for the project as a whole far in excess of the amount of its individual contract. If one subcontractor's default in performance is the source of the problem, the Owner – even if named as a so-called "dual obligee" on all of the subcontractors' Performance Bonds – might have significant difficulty in successfully enforcing the Performance Bonds against the other subcontractors who themselves may have performed in accordance with their respective obligations.

In addition, even assuming that the defaults in performance would all be at the subcontractor level, and that each subcontractor's default in performance only produced consequences in proportion to the original cost of that subcontractor's work, the Owner with rights on several subcontractor Performance Bonds would still be at a disadvantage by comparison with an Owner holding a single 100% Performance Bond from the CM-At Risk. One of the advantages of a single 100% Performance Bond supplied to the Owner by a CM-At Risk is that, at the point when enforcement is required, the Owner has a single bonding company and a single bond against which to assert its claims. Administratively, the Owner would only need to make one claim. In terms of the potential for delay and finger-pointing, the Owner would only need to make the demand for the project as a whole, because the CM-At Risk has responsibility for the entire project. The same cannot be said if the Owner is required to make multiple claims on multiple bonds, administratively or substantively. As we understand from Mr. VanHook himself and others, part of the rationale for revising the APs to permit an optional

CM-At Risk methodology, rather than a CM-Advisor/Agent one, was to provide the Owner with essentially one point of contact for a CM default. In short, even in best case scenarios, reliance on a series of subcontractor Performance Bonds simply does not provide the same degree of administrative simplicity and conflict avoidance that are likely to be achieved by a single CM-At Risk Performance Bond for 100% of the Contract Sum.

If the CMs-At Risk are permitted to provide Performance Bonds and Payment Bonds only up to the level of their respective fees, the Owner is potentially exposed to greater risk and expense than it otherwise would be. The 2007 APs, the KMPC and the Contract Documents have been written in a manner that, if implemented, avoids such risks and exposures for the Owner.

EVOLUTION OF AOC'S PRACTICE

Between the 2000 and 2005 version of the APs, the AOC utilized a CM-Advisor/Agent project delivery method in addition to a GC project delivery method. With the 2005 APs, the AOC eliminated the CM-Advisor/Agent methodology and replaced it with the CM-At Risk project delivery method.

From 2000 to 2005, each subcontractor furnished a Performance and Payment Bond equivalent to its respective subcontract amount. Importantly, however, the Owner executed a contract with each of the subcontractors and had the right to pursue each subcontractor for default of the subcontractors' performance or payment obligations. The Owner could also pursue the subcontractor's bonding company, if necessary, in the event of the subcontractor's default.

When the AOC switched to a CM-At Risk project delivery method in 2005, it merely required that the CM-At Risk post a Performance and Payment Bond equivalent to the amount of its fee. The AOC has not objected when the CM-At Risk's subcontractors furnish Performance and Payment Bonds equivalent to their respective subcontract amount, with the CM-At Risk and the Owner as dual obligees. The Owner, however, is not in privity of contract with those subcontractors; and as referenced above, the 2007 APs prohibit any kind of relationship existing, contractual or otherwise, between the Owner and those subcontractors. In such a circumstance, the Owner generally cannot pursue a claim against the subcontractor. In the event that the CM-At Risk defaults, the Owner generally cannot pursue a claim against the subcontractor's bonding company, if necessary, because the subcontractor has not defaulted.

It is our belief that the AOC has operated on the inaccurate assumption since 2005 that the courthouse projects, utilizing a CM-At Risk, are 100% bonded; but, in reality, those projects are not bonded in accordance with the APs, the KMPC or the Contract Documents. A project's being "100% bonded" is not the same as the CM-At Risk's furnishing a Performance and Payment Bond equivalent to 100% of the Contract Sum.

Based upon our investigation, it appears that the AOC's current practice of allowing CMs-At Risk to furnish Performance and Payment Bonds which are contrary to the APs, the

KMPC and the Contract Documents has developed, in part, as a result of a December 18, 2007 meeting among AOC representatives and certain architectural/engineering firms and construction managers which were involved with Courthouse Construction Program projects at that time. On December 18, 2007, AOC representatives met at the AOC's offices in Frankfort, Kentucky with representatives of the following construction managers: Codell Construction Company, Branscum Construction, Inc. and Alliance Corporation; and with the following architectural/engineering firms: Bennett Rosser Architects, Louis & Henry Group, Murphy & Graves Architects, DLZ Corporation, Brandstetter Carroll, Inc., Sherman Carter Barnhart, PSC, CMW, Inc. and JRA Architects. As we understand, the intended purpose of the meeting was to discuss how the Architects and CMs could work better and communicate more effectively with each other, particularly during the pre-construction phases of the projects.

During the course of the December 18, 2007 meeting, the AOC representatives apparently discussed with the construction managers present the need to have each project "100% bonded" and suggested that the CMs furnish Performance and Payment Bonds equivalent to 100% of the Contract Sum. Apparently, one of the construction managers proposed to accomplish "100% bonding" through the CM-At Risk's furnishing Performance and Payment Bonds equivalent to their fee and requiring each of their subcontractors to submit Performance and Payment Bonds for their respective subcontract amounts and designating both the CM-At Risk and the Owner as obligees (dual obligees). The CMs stated that the AOC's requiring an "additional layer" of Performance and Payment Bonds from the CMs for 100% of the Contract Sum would constitute "double bonds" and an unnecessary expense for the Owner. We do not believe that the AOC was requiring "double bonds" as the AOC was merely enforcing the terms of the 2007 APs by discussing the requirements for the CM-At Risk's furnishing of a 100% Performance and Payment Bond. The 2007 APs do not require that the CM-At Risk and its subcontractors provide two layers of bonds with dual obligees. Nonetheless, the construction managers in attendance at the December 18, 2007 meeting apparently convinced the AOC representatives who were present at the meeting otherwise. As a result of this meeting, the AOC did not thereafter object when at least the construction managers in attendance at the meeting furnished Performance and Payment Bonds with a penal sum equivalent to their fee only.

We anticipate that the construction managers, which were attendance at the December 18, 2007 meeting, will contend that Mr. Garlan VanHook, the former Executive Officer of the AOC Department of Facilities, had the right to make a final determination with respect to the bonding requirements as a result of a provision within the Preface section of the 2007 APs, which reads as follows:

> **Conflicts:** In the event that any, section, [sic] of AP Part X conflicts with any other, the AOC General Manager of Court Facilities shall make the final determination which section prevails and which is most beneficial to the COJ. This determination is final, carries the force and effect of AP Part X, and shall be applied and/or executed without any effect to any other chapter, paragraph, or statement contained herein, including any changes, and/or amendments as described above.

In our opinion, however, no sections of the 2007 APs are in conflict which might trigger this provision. Based upon our review to date, we have not located any requests made of Mr. VanHook to render a final determination between allegedly conflicting sections of the 2007 APs. Indeed, Mr. VanHook himself has confirmed that no one requested that he render a final determination regarding any allegedly conflicting sections of the 2007 APs, and that he has made no such determination.

Even if such a written request for final determination had been made to modify the bonding requirements for a GC or CM-At Risk on a Courthouse Construction Program project, any such final determination would not have been valid and binding unless it had been approved in writing by the Chief Justice through a Court Order. As you recall, the Chief Justice, in accordance with the specific language of the 2007 APs, retains complete authority for approval of procedures within the Courthouse Construction Program; and only the Chief Justice can make permanent changes to the bonding requirements for GCs or CMs-At Risk through a Court Order. Since the Chief Justice has not made such a permanent change, any contention that Mr. VanHook rendered a final determination, modifying the bonding requirements for a GC or CM-At Risk, lacks total merit.

We also anticipate that certain construction managers might argue that the AOC is estopped from changing the current, but improper, practice of officials at AOC requiring a CM-At Risk to furnish a Performance and Payment Bond equivalent to only its fee, that the AOC has somehow waived its ability to enforce the strict requirements of the 2007 APs, the KMPC and the Contract Documents, that certain construction managers have detrimentally relied upon the AOC's inappropriate practice of requiring that the CM-At Risk only provide a Performance and Payment Bond equivalent to its fee, or that the AOC has somehow changed the conditions of the contract. Again, we believe that these anticipated arguments lack merit. As referenced above, the Chief Justice has ultimate authority to modify procedures contained within the APs; and, based upon our investigation and as confirmed by Mr. VanHook, the Chief Justice has not modified the bonding requirements for CMs-At Risk. The A121/CMc agreement, at Section 9.2.2, contains standard language that the contract may be amended only by written instrument signed by both the Owner and Construction Manager; and, based upon our investigation, no such written amendment exists. Section 13.4.2 of the AIA General Conditions contains the standard language providing that no action or failure to act by the Owner shall constitute a waiver of any right or duty afforded to the Owner under the contract. Additionally, both sections 9.2.2 of the A121/ CMc and paragraph B of Section II of Appendix E to the 2007 APs (page E-13) contain the standard language that the Contract Documents supersede all prior negotiations, representations or agreements, either written or oral, between the Owner and the CM-At Risk. Also, enforcing the CM-At Risk's bonding requirements, which have been in existence since August 9, 2005, is hardly a changed condition or circumstance. Again, the 2007 APs and the Contract Documents do not support any possible argument for estoppel, waiver, detrimental reliance, changed condition or similar argument which a CM-At Risk might make.

Through our investigation, we understand how the AOC's practice of not objecting to a CM-At Risk's furnishing a Performance and Payment Bond equivalent only to its fee has

evolved; but such practice is inconsistent with the 2007 APs, the KMPC and the Contract Documents.

"DOUBLE BONDING"

Before we conclude this opinion, we must emphasize that we are not concluding that Kentucky Law and the Contract Documents require both the GC or the CM-At Risk and their respective subcontractors to furnish a 100% Performance and Payment Bond. Some of the CMs-At Risk and others whom we have contacted during our review have referred to such program as "double bonding," whereby the Owner pays for two levels of bonds, namely, one level of bonds being the GC's or CM-At Risk's posting of a 100% Performance and Payment Bond and the second level being the subcontractor's or supplier's furnishing of a Performance Bond and Payment Bond, equivalent of the amount of their respective contract. The 2007 APs, the KMPC and the Contract Documents simply do not impose any requirement for "double bonding." If a GC or a CM-At Risk decides to require that one or more of its subcontractors or suppliers furnish a Performance and/or Payment Bond, the GC or CM-At Risk can certainly do so at its discretion and at its expense. Neither the Owner nor the taxpayer should incur that cost. In the event that the GC or CM-At Risk chooses to require that one or more of its subcontractors or suppliers furnish a Performance Bond or Payment Bond, it is imposing such bonding requirements to protect itself, not the Owner.

The 2007 APs, the KMPC and the Contract Documents only require that the GC or CM-At Risk furnish a 100% Performance and Payment Bond, with the Owner as the obligee. The concept of "double bonding" or the Owner's paying for two levels of Performance and Payment Bonds within the Courthouse Construction Program is a "red herring" raised by certain CMs-At Risk within the program in an apparent effort to avoid the actual requirements of the 2007 APs, the KMPC and the Contract Documents.

CONCLUSION

Based upon our review, we have concluded that the 2007 APs, the KMPC and the Contract Documents each provide an independently sufficient requirement that a GC or CM-At Risk furnish a single Performance and Payment Bond or a separate Performance Bond and Payment Bond, equivalent to 100% of the Contract Price or Contract Sum, with the Owner as the obligee, upon the execution of its contract with the Owner. Any contention to the contrary lacks merit.

Respectfully submitted,

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